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In the Supreme Court of the United States

OCTOBER TERM, 1978

THE SUPERIOR OIL COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statement	2
Argument	6
Conclusion	10

CITATIONS

Cases:

American Public Gas Ass'n, 555 F. 2d 852, certiorari denied February 28, 1978 (No. 77-695)	4
Austral Oil Co. v. *Federal Power Commission*, 560 F. 2d 1262	4
California v. *Southland Royalty Co.*, No. 76-1114, decided May 31, 1978	9
Mobil Oil Corp., 49 F.P.C. 239	3, 7
Opinion No. 639, 48 F.P.C. 1299	2, 3
Opinion No. 639-A, 49 F.P.C. 361, affirmed *sub nom. Shell Oil Co.* v. *Federal Power Commission*, 491 F. 2d 82	2
Opinion No. 699-H, 52 F.P.C. 1604, affirmed, *Shell Oil Co.* v. *Federal Power Commission*, 520 F. 2d 1061, certiorari denied *sub nom. California Co.* v. *Federal Power Commission*, 426 U.S. 941	4
Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672	2
Statement of General Policy, No. 61-1, 24 F.P.C. 818	2

Cases—Continued

	Page
Sunray Mid-Continent Oil Co. v. *Federal Power Commission*, 364 U.S. 137	3, 9-10
Udall v. *Tallman*, 380 U.S. 1	7

Statutes and regulations:

Natural Gas Act, Section 19(b), 52 Stat. 831, as amended, 15 U.S.C. 717r(b)	2
18 C.F.R. 2.56a(a)(2)(iii) (1976)	3
18 C.F.R. 2.56a(a)(5)(i) (1977)	3

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 569 F.2d 971. The orders of the Commission (Pet. App. C, D) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. A-1) was entered on March 20, 1978, and its order

denying a petition for rehearing was entered on April 20, 1978 (Pet. App. B). The petition for a writ of certiorari was filed on June 20, 1978. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 52 Stat. 831, as amended, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the Federal Power Commission properly rejected a rate increase filed by petitioner as inconsistent with the Commission's replacement contract policy.

STATEMENT

1. Under the Natural Gas Act, 52 Stat. 821-833, as amended, 15 U.S.C. 717-717w, the Commission has the authority to regulate the rates charged by producers for sales of natural gas for resale in interstate commerce. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672.

In 1960, the Commission adopted a rate-making technique that priced gas at different rates on the basis of the date of the sales contract. Under this program, known as "vintaging," gas produced under contracts signed before an established "division" date was set at one price as "old" gas, while gas produced under contracts signed after the division date was allowed a higher price as "new" gas. *Statement of General Policy No. 61-1*, 24 F.P.C. 818.

In 1973, in Opinion Nos. 639, 48 F.P.C. 1299, and 639-A, 49 F.P.C. 361, affirmed *sub nom. Shell Oil Co.* v. *Federal Power Commission*, 491 F.2d 82 (C.A. 5), the Commission initiated its replacement contract pol-

icy. This policy was designed gradually to eliminate vintaging. To minimize the economic dislocations that would result if all "old" gas were suddenly allowed to be sold at the higher rates, the replacement policy permits gas sold under a new contract to be treated as new gas if the new contract replaces a prior contract (signed before the division date) that has expired by its own terms.[1] Thus, over time, "old" gas would gradually disappear. 48 F.P.C. at 1310, 49 F.P.C. at 364.

Thereafter, the Commission refined this policy in individual cases and through the promulgation of specific regulations. In 1973, in *Mobil Oil Corp.*, 49 F.P.C. 239, the Commission held that where a contract was renegotiated prior to the termination of the original contract, the replacement contract policy was inappropriate until the original contract had expired. In 1974, the Commission codified the replacement contract policy in the Commission's regulations (18 C.F.R. 2.56a(a)(2)(iii) (1976) (as revised, now appearing at 18 C.F.R. 2.56a(a)(5)(i) (1977)). See

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[1] *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 364 U.S. 137, established that once gas reserves are dedicated to interstate commerce under an unlimited certificate, the expiration of a gas sales contract does not authorize the abandonment of that service; the Commission may still require the continuation of the service at Commission-established rates. In establishing its rate structure, however, the Commission may take the expiration of contracts into account. It may, as it has in its replacement policy, make such expirations relevant in determining the vintage of gas.

Opinion No. 699-H, 52 F.P.C. 1604.[2] The Commission reaffirmed that, in order to avoid "severe and harmful economic dislocations," vintaging would be gradually phased out. 52 F.P.C. at 1638 n. 118. Later, the Commission disallowed a proposed replacement contract rate where the parties to a contract had executed an amendment reducing its term and then entered into a new contract replacing the foreshortened original contract. *Austral Oil Co.*, F.P.C. Gas Rate Schedule Nos. 9 and 23, and *Amoco Production Co.*, F.P.C. Gas Rate Schedule No. 190, letter orders (April 30, 1976), rehearing denied (August 3, 1976).[3] Moreover, in Opinion No. 770-A, issued November 5, 1976,[4] the Commission explained (slip op. 22) that under this policy "the base contract must run its full 'primary term' before the expiring contract can 'roll-over,' and thus qualify under a replacement contract for the [higher] rate," and that "[b]y 'primary term'," it "mean[t] the actual term of years specified in the base contract, and not as the base contract may be affected by a premature termination provision contained therein * * *" (Pet. 17; Pet. App. D-4).[5]

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[2] Affirmed, *Shell Oil Co.* v. *Federal Power Commission*, 520 F.2d 1061 (C.A. 5), certiorari denied *sub nom. California Co.* v. *Federal Power Commission*, 426 U.S. 941.

[3] Affirmed, *Austral Oil Co., Inc.* v. *Federal Power Commission*, 560 F.2d 1262 (C.A. 5).

[4] Affirmed *sub nom. American Public Gas Ass'n*, 555 F.2d 852 (C.A. D.C.), certiorari denied February 28, 1978 (No. 77-695).

[5] See also *Skelly Oil Co.*, Order on Remand (February 14, 1977), rehearing denied *sub nom. Getty Oil Co.*, No. 77-1993 issued July 5, 1977, appeal pending, *Getty Oil Co.* v. *Federal Energy Regulatory Commission* (C.A. 10, No. 77-1993).

2. In 1953, petitioner, a producer of natural gas, entered into a contract with a predecessor to Michigan-Wisconsin Pipe Line Company for the sale of gas in interstate commerce. The contract provided for an indefinite term and was to remain effective until delivery of all reserves in the committed acreage, failure of the acreage to produce in paying quantities, or reduction in the amount of gas available to the purchaser to the extent that operation of its pipeline would no longer be profitable (Pet. App. A-4). The contract also provided for premature termination if the parties were unable to negotiate a new price for gas delivered after August 15, 1976 (*ibid*). Pursuant to this last provision, petitioner terminated the original contract as of August 15, 1976, and entered into a new contract with Michigan-Wisconsin effective on August 15, 1976, which provided for a higher price (*ibid.*).

On August 23, 1976, petitioner filed a proposed rate increase with the Commission requesting the replacement contract rate specified in Commission Opinion No. 770. The Commission rejected the proposed rate increase on the grounds that the primary term of the original contract had not expired (Pet. App. C). The Commission denied rehearing and further explained that the original contract had not expired of its own terms within the meaning of the Commission's replacement contract policy, because under that policy a replacement contract rate is not available when a contract was prematurely terminated either by a pro-

vision of the contract or by subsequent agreement of the parties(Pet. App. D).

The court of appeals affirmed the Commission's orders (Pet. App. A). It held that the Commission's decision was reasonable and consistent with the replacement contract policy. The court determined that insofar as the Commission's decision embodies the notion that a contract does not expire of its own terms for purposes of the replacement contract policy if termination results from the seller's voluntary exercise of a contractual right to terminate, the decision is consistent with a reasonable interpretation of that policy. The court found "[a] policy that allowed contracting parties unrestricted freedom to bring themselves within its ambit could not be expected to eliminate vintaging gradually" (Pet. App. A-7 to A-8). The court also held that the Commission had not altered the non-rate terms of petitioner's gas sales contract, but had only determined the proper rate at which petitioner could sell its gas, a function within the authority of the Commission (Pet. App. A-8).

ARGUMENT

The court of appeals correctly held that the Commission's rejection of the proposed rate increase was consistent with the Commission's replacement contract policy and within the scope of the Commission's authority. The decision below presents no issues of general importance, raises no conflict with other decisions and does not warrant this Court's review.

1. Petitioner errs in contending (Pet. 11-12) that the replacement contract policy applies whenever a contract expires pursuant to any provision in it, including those that effectively permit one or both of the parties to terminate the contract unilaterally or by agreement. The Commission held otherwise and that holding is consistent with its decisions and orders in other cases. See pages 3-4, *supra*.[6] Absent clear evidence of irrationality or arbitrariness, the Commission's consistent interpretation of its own policy should be honored. See, *e.g.*, *Udall* v. *Tallman*, 380 U.S. 1, 16-17.

Moreover, as the court of appeals recognized, and contrary to petitioner's claim (Pet. 17-18), the Commission's conclusion that replacement contract rates are not triggered by terminations resulting from unilateral or bilateral conduct of the parties is not only reasonable but also essential to the purpose of the replacement contract policy, which was to avoid the sudden and complete elimination of old gas rates. As the court of appeals stated (Pet. App. A-7 to A-8):

> The purposes of the policy are to eliminate contract vintaging and to do so in a fashion suffi-

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[6] Petitioner's claim (Pet. 14-18) that the policy applied to this case was first established in November 1976, in Opinion No. 770-A, and applied retroactively to petitioner's termination in August 1976, is incorrect. The policy applied here and announced in Opinion 770-A was in accord with principles stated in 1973 in *Mobil Oil Corp.*, 49 F.P.C. 239 and applied to other companies before petitioner's termination. See pages 3-4, *supra*. As noted in the text, it is also implicit in the purpose of the replacement contract policy.

ciently gradual to minimize the economic dislocation that could result from categorical rate increases for old vintage contracts. In this case an event entirely within the control of the contracting parties led to the termination of the contract. Absent that event performance of the contract could have continued for the life of the reserves committed. Insofar as the FERC decision embodies the notion that a contract does not expire of its own terms within the meaning of the replacement contract policy if termination results from the seller's voluntary exercise of a contractual right to terminate, the decision is consistent with a reasonable interpretation of the replacement contract policy. A policy that allowed contracting parties unrestricted freedom to bring themselves within its ambit could not be expected to eliminate vintaging gradually.[7]

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[7] *Skelly Oil Co.* v. *Federal Power Commission*, 532 F.2d 177 (C.A. 10), on which petitioner relies (Pet. 18-21), is inapposite. The court of appeals' decision in *Skelly* was based on the fact that the prior contract had terminated because of facts beyond the control of the parties—loss of gas pressure—and the court on that basis distinguished the Commission's earlier decision in *Mobil Oil Corp.*, 49 F.P.C. 234 (532 F.2d at 179-180). Here, in contrast, the prior contract was purportedly terminated by the voluntary and unilateral action of petitioner. As the Commission and the court below noted, to permit replacement contract rates on the basis of such actions would vitiate the purpose of the replacement contract policy.

Moreover, in *Skelly*, the court of appeals left open the question whether the Commission could require that all base contracts must run their full primary terms for replacement contract purposes, regardless of provisions for termination resulting from conditions beyond the control of the parties, since the Commission had not based its decision on that theory (532 F.2d at 180). On remand the Commission again denied the replacement contract rate expressly on that theory (*Skelly Oil Co.*, Order On Remand, February 14, 1978, see also Order No. 770-A, page 4, *supra*), and that decision is pending on appeal. *Getty Oil Co.* v. *Federal Energy Regulatory Commission* (C.A. 10, No. 77-1993). Whether or not the Tenth Circuit will affirm that theory is immaterial since this case involves a termination within the control of the parties and therefore does not depend on that theory.

2. Petitioner contends that the Commission exceeded its authority by modifying the non-rate terms of its original gas sales contract when it found that the contract provided for an unlimited term (Pet. 23-27). The court of appeals correctly rejected that contention (Pet. App. A-8):

> Superior's argument that the FERC, in rejecting the rate increase of the 1976 contract, exceeded its authority by modifying the non-rate terms of a gas sales contract misconceives the effect of the FERC decision. The decision affects only the rate at which Superior can sell its gas. This effect is within the authority of the agency. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 * * *. The FERC decision does not bind the parties to the non-rate terms of either the 1953 contract or the 1976. The decision concludes only that the rate increase contained in the 1976 contract is not a rate increase permitted by the replacement contract policy.

Moreover, the Commission's authority to require the continuation of dedicated service at Commission rates notwithstanding the terms of a private contract is well established. *California* v. *Southland Royalty Co.*, No. 76-1114, decided May 31, 1978; *Sunray Mid-*

Continent Oil Co. v. *Federal Power Commission*, 364 U.S. 137.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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